IdahoTrust

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WealthManagement

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Market Insights

A periodic newsletter from Idaho Trust

The Federal Reserve Bank raised the benchmark Fed Funds rate at its December meeting. The increase came at a time when the U.S. economy is experiencing solid gains in economic activity levels. The U.S. dollar has been strong over the past year relative to other major currencies. At this point, many unknowns remain surrounding the eventual impact from the new Republican administration and its policy initiatives.

Interest Rates

At the mid-December meeting, the Federal Reserve Bank (Fed) raised interest rates for the second time in nearly a decade. Despite all of the attention surrounding this increase, interest rates remain at very low levels. The target range of the Fed funds is now 0.50% – 0.75%. The domestic economy has experienced an improvement over the past six months and the Fed members predicted that more rate increases were likely this year and next. Presently, inflation appears very low, although it has ticked up a bit in the past six months.

The Chairperson of the Federal Reserve Bank, Janet Yellen, did an extremely good job of preparing the financial markets for a rate increase. In fact, an increase in interest rates was priced into the market well before the actual announcement. The Fed appears to want to act before there are actual signs of inflation. The

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central bank made a big effort to convey the idea that economic activity levels will determine the path and timing of future interest rate increases. During the last tightening cycle of the Federal Reserve, it raised interest rates by 0.25% at 17 straight meetings. This time, the Fed has made it clear that there will be no predetermined path.

Gross Domestic Product

The third quarter (3Q) Gross Domestic Product (GDP) was revised up to 3.5%, from the initial reading of 3.2%. The 3Q results represent an acceleration from the lackluster level of 1.4% gain experienced in the second quarter. The gains were broad based and activity levels improved in a majority of the industries. Recall that corporate earnings declined over the past year as lower energy prices caused sharp reductions in capital expenditures. The headwinds of lower energy prices have past as oil prices are now in the mid $50 per barrel range. Consumer spending, which accounts for more than two-thirds of U.S. economy, continues to demonstrate healthy gains, supported by a better labor market and rising home values.

Year-end Review

Last year was an interesting time in the investment markets. The financial markets started the year on very rocky footing. January was one of the worst starts to a year in an exceptionally long time. Many investors believe that the performance of the first month of the year is a good indication of how the remainder of the year will turn out. This was certainly not the case last year. The S&P 500 rose 11.95%, including dividends, which represents a solid performance.

Dividends are an important part of total returns and corporations have increased the dividends they have paid for the past seven years. The aggregate level of dividends paid to investors increased by 5.53% in 2016. Over the last seven years, dividends have grown at an average rate of 10.72% per year. Investors sometimes overlook the importance of dividends. Going back to the market low point in March 2009 until year end 2016, the S&P 500 gained 233.7%. But the S&P 500 Total Return Index, which includes dividends, gained 294.1%. The lesson is that reinvesting your dividends is a powerful tool for long-term investors. One interesting aspect of the recent earnings recession is that it didn't hit dividends terribly hard. That was probably a sign that the corporate earnings drop was likely temporary.

Small cap stocks had an exceptionally bad start to the year, down 17% in the first four weeks. However, circumstances changed dramatically and the small cap equities, as measured by the Russell 2000, rose 21.3% in 2016. The idea behind a broad based asset allocation plan is relatively straight forward: when one market segment struggles, those results are offset by other areas that are thriving. Domestic equity markets as well as emerging equity markets generated solid advances. However, developed international markets experienced very modest gains, up only 1.0% in 2016.

Generally speaking, fixed income investments produced modest gains as the Fed raised interest rates towards the end of the year. Another interesting development was Commodities: (1) in 2015 they had fallen to their lowest levels in a decade as low global inflation reduced the value of precious metals; (2) weak Chinese demand hurt raw-materials prices; (3) and a global supply glut sent crude oil prices tumbling. However, an improvement in global economic activity sent commodities prices higher in 2016 (as a group prices rose almost 12%).

2016 Market Returns

Broad Market Returns	
S&P 500	11.95%
Dow Jones Industrial Average	16.50%
Nasdaq	8.97%
MSCI EAFE	1.00%
MSCI Emerging Markets	11.27%
US Bond Index	2.65%
Russell 2000 - small cap	21.28%
Corporate Bonds	5.93%
Municipal Bonds	0.77%
Treasuries	1.03%
Commodities	11.77%
Foreign Bond Index	1.62%
Domestic Stock Sectors	
Information Technology	13.85%
Financials	22.75%
Health Care	-2.69%
Energy	27.36%
Consumer Discretionary	6.03%
Consumer Staples	5.38%
Industrials	18.85%
Utilities	16.29%
Materials	16.69%
Telecommunication Services	23.49%
Real Estate (REITs)	9.00%

Conclusion

The total return for the S&P 500 in 2016 was up sharply from the 1.37% experienced in 2015. Despite the solid returns in domestic equity markets, most of these came in the latter portion of the year. Many International developed economies struggled with weak demand, which negatively impacted their equity markets. Given the relatively healthy state of the domestic economy, the pace of Fed interest rate increases will certainly have an impact on the financial markets. Another important variable will be the changing political and fiscal policy environment, which has created many uncertainties; from infrastructure spending to the impact from changes in trade deals by the new administration. Uncertainty surrounding these issues could create volatility this year, but the underlying foundation of economic health remains strong.

S&P 500 Index

3 Month	4.14%
Year-to-Date	11.95%
1 Year	11.95%
3 Year	9.22%
5 Year	14.31%

MSCI EAFE Net Index

3 Month	-0.79%
Year-to-Date	1.00%
1 Year	1.00%
3 Year	-1.31%
5 Year	6.03%

Barclays Aggregate Bond Index

3 Month	-2.93%
Year-to-Date	2.65%
1 Year	2.65%
3 Year	3.02%
5 Year	2.28%

As of 12.30.2016

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